45. Explain and provide documentation of the extent the possibility of future downsizing or layoffs were accounted for. (¶ 27)

AT&T used a 5-year average historical rate for downsizings and layoffs projected forward to account for future downsizings and layoffs in the SFAS 112 transition amount. Specifically, AT&T's own actual average historical separation experience during the five-year period from 1988 through 1992 forms the basis for its SFAS 112 transition accrual amount. AT&T assumed that the same percentage of employees who terminated or retired during that period with a postemployment separation benefit would do so each year thereafter until all employees on the payroll as of year-end 1993 had terminated or retired or otherwise left the Company.

AT&T then applied the postemployment severance pay schedules (years of service to weeks of severance pay) to the estimated future pay of those current employees anticipated to terminate or retire with a postemployment separation benefit to calculate the estimated postemployment separation benefits for each future year. A portion of those postemployment separation benefits is allocated to years of service rendered by the employees prior to January 1, 1994. That allocation is based on the ratio of the years of service rendered prior to the adoption of SFAS 112 for each employee over the total years of service at expected future termination or retirement with a postemployment separation benefit. Once this allocation is made, the transition amount is the present value of all future benefits after applying the allocation ratio.

<u>See</u> <u>also</u> Response to Issue No. 42.

46. Provide information on what adjustments have been made to SFAS-112 amounts for any layoffs or downsizing that have occurred since the adoption of SFAS-112. Give full details. (¶ 27)

There were no subsequent adjustments to the SFAS 112 transition amount for downsizings that took effect after the PCI adjustment on November 30, 1994.

<u>See</u> Response to Issue No. 50.

<u>Miscellaneous Supporting Information</u>

47. Provide information on average total compensation per employee and the amount of this total compensation represented by postemployment benefits. Provide similar data for the economy as a whole. (¶ 28)

<u>See</u> Pleading Section II and Appendix H.

48. Describe the provisions that have been made, if any, to return to ratepayers the over-accrual, if any, of the non-cash expenses if exogenous treatment is given for these

amounts. Describe any plans to return money through voluntary PCI reductions or other means. (¶ 29)

AT&T's SFAS 112 exogenous adjustment did not include any specific mechanism for returning over-accruals, if any, to ratepayers. Competition has exerted downward price pressure on AT&T's rates, thereby eliminating the need to make an adjustment for this one particular cost factor.

Moreover, the assumptions as to the transition amount were reasonable when made and are fully supportable. The plan changes and changes in assumptions that have taken place since the adoption of SFAS 112 in fact indicate that the transition amount sized at adoption represents an under-accrual.

See Response to Issue No. 50.

49. Describe how these gains from over-accruals are recognized on AT&T's books of account. (¶ 29)

In terms of how gains and losses are recognized on the books of account, the net unrecognized gains or losses for current and prior years is recognized on an amortized basis for Postemployment Separation Benefits. The amortization period is the average remaining service period of active participants expected to receive Separation Benefits. For Long Term Disability-Income Replacement and Long Term Disability-Medical benefits, the gains are recognized immediately.

50. Document any and all changes made in postemployment benefits offerings to employees and submit any new contracts with employees and their representative unions affecting postemployment benefits. In particular, we are interested in determining whether any underlying actuarial assumptions have changed. (¶ 30)

Appendix G describes the changes to the Postemployment Separation Benefits, Long Term Disability-Income Replacement, and Long Term Disability-Medical benefits that have occurred since SFAS 112 was implemented. (For comparison, the benefits used in computing the SFAS 112 transition amount are described in Appendix B). In particular, as to Postemployment Separations Benefits: (1) the severance pay schedules have improved for both Management and Nonmanagement employees; and the (2) duration of medical coverage for Management employees entitled to severance has doubled for employees with more than one year of service. As to Long Term Disability-Income Replacement for Management employees, the definition of "eligible pay" has changed from basic pay to also include certain lump sum payments and differential payments which are included under the definition of compensation under the AT&T Management Pension Plan. As to Long Term Disability-Medical benefits, various changes have been made for both Nonmanagement and Management employees. The primary enhancements include a new Mental Health and Chemical Dependency Program, a new Prescription

Drug Program, and the elimination of coinsurance for Nonmanagement employees which is to be replaced by a $10 co-payment per visit for most in-network medical services.

Although the Postemployment Separations Benefits in AT&T's SFAS 112 computation did not include the costs of Company-provided Transition Assistance, in 1995 AT&T made a number of revisions to the Transition Assistance Program that allows employees entitled to Postemployment Separations Benefits to obtain a total of $10,000 of reimbursement over two years for: further formal education/training; relocation allowance if the employee's new work location is 25 miles or more from his or her former residence; and new business start-up expenses including equipment, legal fees, advertising and marketing.

* * *

The following changes as to actuarial assumptions have been made since SFAS 112 adoption.

- The discount rate used in determining the SFAS 112 transition amount was 8.25%. Effective January 1, 1996, the discount rate will be significantly less than 8.25%. While the exact discount rate has not yet been determined, it is very unlikely to exceed 7.25%.

  AT&T uses the same discount rate for SFAS 112, 87 and 106. Thus, changes in discount rates apply to all three types of expenses assuring consistency.

- Subsequent to adoption of SFAS 112, AT&T has included in its ongoing SFAS 112 costs the impact of employer-paid FICA taxes with respect to Postemployment Separation Benefits.

- Based on experience since adopting SFAS 112, AT&T has increased its assumption with respect to termination from Long Term Disability status.

- The SFAS 112 transition amount was based on the average downsizing rates for the five year period 1988-92. The downsizing rates for the five year period 1991-95 have increased for Management employees and decreased for Nonmanagement employees.

The AT&T company-wide SFAS 112 transition amount would have been approximately $210 million <u>higher</u>, if the above changes in assumptions (including a 7.25% discount rate) had been reflected in the original $2.1 billion transition amount as of January 1, 1994.

B

Further Response to Issue No. 2

AT&T BENEFITS USED IN SFAS 112 COMPUTATION

This Appendix sets forth the AT&T benefits used in determining the SFAS 112 transition amount.

I. Postemployment Separation Benefits

A. The Medical Benefits described in Section III of this Appendix are available for a limited period to employees entitled to severance benefits as shown below:

Service	Months of Medical Coverage
Less than 1 year	0
1 to 5 years	3
5 or more years	6

B. AT&T NONMANAGEMENT SEVERANCE SCHEDULE

Service (years)	Manufacturing (weeks base pay)	Operations (weeks base pay)
1	1	1
2	2	2
3	3	3
4	4	4
5	5	6
6	6	8
7	7	10
8	9	12
9	11	16
10	13	20
11	15	24
12	17	28
13	19	32
14	21	36
15	24	40

B. AT&T NONMANAGEMENT SEVERANCE SCHEDULE (continued)

Service (years)	Manufacturing (weeks base pay)	Operations (weeks base pay)
16	28	44
17	32	48
18	36	52
19	40	56
20	44	60
21	48	64
22	52	68
23	56	72
24	60	76
25	64	80
26	68	84
27	72	88
28	76	92
29	80	96
30	84	100
31	88	104
32	92	104
33	96	104
34	100	104
35	104	104
36	104	104
37	104	104
38	104	104
39	104	104
40	104	104
41	104	104
42	104	104
43	104	104
44	104	104
45	104	104

C. AT&T MANAGEMENT SEVERANCE AND SUPPLEMENTAL SCHEDULES

Severance Schedule

Service (years)	Weeks Base Pay
0.5	4
1	5
2	6
3	7
4	8
5	9
6	10
7	11
8	12
9	13
10	14
11	15
12	16
13	17
14	18
15	19
16	20
17	21
18	22
19	23
20	24
21	25
22	26
23	27
24	28
25 +	29

Supplemental Schedule

(Employees whose age + service equals 45 years or more)

Combined Whole Years of Age And Service	Additional Weeks Base Pay
45 - 49	2
50 - 54	3
55 - 59	4
60 +	5

Note: employees terminated with a severance benefit who sign a Termination Agreement and Release receive an additional "Release Bonus" equal to 20% of the sum of the Postemployment Payment and the Postemployment Payment Supplement (if applicable).

II. Summary of AT&T Long Term Disability - Income Replacement Benefit Provisions

The Long Term Disability - Income Replacement Plan provides a benefit of 50% of base pay after a 52 week elimination period. The benefit is offset by certain income from other sources, including Social Security, Workers Compensation, State or Federal disability benefits, and any AT&T pension benefits.

The benefit ceases upon death, recovery or the fulfillment of the maximum duration as indicated below.

Age when LTD Benefit Begins	Maximum Duration of Benefits
61 or younger	To age 65
62	2½ years
63	2 years
64	1½ years
65	1 year
66	¾ year
67	½ year
68	¼ year

III. Long Term Disability - Medical Benefits Summary

Table 1
Cost Sharing

1.0	Cost Sharing	Management	Nonmanagement		
			In-Network	Out-of-Network	Out-of-Area/PPP
1.1	Deductible (Individual/Family)	Based on pay $150-300/ $450-$900	Based on pay $150-$300/ $450-$900	$200/$400	Based on pay $150-300/ $450-$900
1.2**	Office Copayment/ Coinsurance	80%	80%	80%	80%
1.3	Medical Care				
	- Diagnostic Lab/ X-ray	100% No Deductible	100% No Deductible	80%	100% No Deductible
	- Anesthesia and Inpatient MD visits	90% No Deductible	90% No Deductible		90% No Deductible
1.4	Surgical Care				
	- Surgery	95% No Deductible	95% No Deductible	80%	95% No Deductible
	- Outpatient Surgery	100% No Deductible	100% No Deductible		100% No Deductible
1.5	Pre Admission Certification	DNA	DNA	DNA	DNA

** Benefits classified as "other covered charges" are limited to $50,000 for each covered person eligible for LTD benefits. The first $3,500 of other covered charges each year do not count towards the $50,000 lifetime limit.

Long Term Disability
Medical Benefits Summary

Table 1, Continued
Cost Sharing

	Cost Sharing	Management	Nonmanagement		
			In-Network	Out-of-Network	Out-of-Area/PPP
1.6	Emergency Room Deductible	DNA	DNA	DNA	DNA
1.7	Hospital Care - Inpatient services semi-private room	≤120 days: 100% >120 days: 80%	≤120 days: 100% >120 days: 80%	80%	100%
	- Inpatient services private room (if only room type available)	≤120 days: 90% >120 days: 80%**	≤120 days: 90% >120 days: 80%**		
	- Outpatient services and other hospital services	100%	100%		
1.8	Home Health Care	100%	100%	80%	70%
1.9**	Private Duty Nursing	80%	80%	80%	80%

** Benefits classified as "other covered charges" are limited to $50,000 for each covered person eligible for LTD benefits. The first $3,500 of other covered charges each year do not count towards the $50,000 lifetime limit.

Long Term Disability
Medical Benefits Summary

Table 1, Continued
Cost Sharing

	Cost Sharing	Management	Nonmanagement		
			In-Network	Out-of-Network	Out-of-Area/PPP
L10	Preventive Services				
	-Physical Exams	Not Covered	Not Covered	Not Covered	Not Covered
	-Mammograms/Pap Smear	80% Limited to 2 visits/year for women over 50	80% Limited to 2 visits/year for women over 50	80% Limited to 2 visits/year for women over 50	80% Limited to 2 visits/year for women over 50
	-Well-woman care	Not Covered	Not Covered	Not Covered	Not Covered
	-Newborn/Well Baby Care	90% Limited to 1 visit	90% Limited to 1 visit	80% Limited to 1 visit	90% Limited to 1 visit
	-Immunizations	Not Covered	Not Covered	Not Covered	Not Covered
L11	Prescription Drugs	80%	80%	80%	80%
L12**	Other Services	80%	80%	80%	80%
L13	Annual Out-of-Pocket Maximum (Individual/Family)	$1,000/None	$1,000/None Includes In- and Out-of-Network	$1,000/None Includes In- and Out-of-Network	$1,000/None

** Benefits classified as "other covered charges" are limited to $50,000 for each covered person eligible for LTD benefits. The first $3,500 of other covered charges each year do not count towards the $50,000 lifetime limit.

Long Term Disability
Medical Benefits Summary

Table 2
Benefit Caps

3.0	Benefit Caps	Management	Nonmanagement		
3.1	Occupational, Physical and Speech Therapy	None	In-Network None	Out-of-Network None	Out-of-Area/PPP None
3.2	Home Health Care and Private Duty Nursing	200 visits/year (HHC Only)	200 visits/year* (HHC Only)	200 visits/year* (HHC Only)	200 visits/year (HHC Only)
3.3	Chiropractic Care	60 visits/year	60 visits/year*	60 visits/year*	60 visits/year
3.4	Skilled Nursing Facility	120 days/admit	120 days/admit	120 days/admit	120 days/admit

* Combined In- and Out-of-Network.

Long Term Disability
Medical Benefits Summary

Table 3
Mental Health and Substance Abuse Benefits

4.0	Mental Health and Substance Abuse	Management	Nonmanagement		
			In-Network	Out-of-Network	Out-of-Area/PPP
4.1	Inpatient MH/SA - Coinsurance	MH/Detox ≤30 days: 100% >30 days: 80% SA 100%	MH/Detox ≤30 days: 100% >30 days: 80% SA 100%	MH/Detox 80% SA 80%	MH/Detox ≤30 days: 100% >30 days: 80% SA 100%
4.2	Inpatient MH/SA - Benefit Cap	MH None SA 30 days/admit 2 admits/lifetime	MH None SA 30 days/admit 2 admits/lifetime	MH 30 days/admit SA 30 days/admit 2 admits/lifetime	MH None SA 30 days/admit 2 admits/lifetime
4.3**	Outpatient MH/SA - Copayment/ Coinsurance	MH (EE unable to work) 80% MH 50% SA 80%	MH (EE unable to work) 80% MH 50% SA 80%	MH (EE unable to work) 80% MH 50% SA 80%	MH (EE unable to work) 80% MH 50% SA 80%
4.4**	Outpatient MH/SA - Benefit Cap	MH None SA 30 visits/year	MH None SA 30 visits/year	MH None SA 30 visits/year	MH None SA 30 visits/year

** Benefits classified as "other covered charges" are limited to $50,000 for each covered person eligible for LTD benefits. The first $3,500 of other covered charges each year do not count towards the $50,000 lifetime limit.

C

SFAS 112 Exogenous Cost Adjustment Calculation
11/30/94
($ in Millions)

Total Company SFAS 112 Expenses	$2,110.4
Portion Attributable to AT&T Communications (based on year-end 1993 Form M - yields 27.3%)	576.1
Interstate Separations Factor	.8149
SFAS 112 Accrual - Interstate	469.5
Less: Pay-As-You-Go Interstate	(55.4)
Expense Net of Pay-As-You-Go	414.1
Less: 10.14% in GNP price index	(42.0)
Total Expense Impact	372.1
Total Revenue Requirement Impact	373.4

	Allocation Percentages	Dollar Value
Basket 1	53.64%	$200.2
Basket 2	.07%	.3
Basket 3	.18%	.7
Capped Services	53.89%	201.2
Other - Noncapped Services	46.11%	172.2
Total Revenue Requirement	100.00%	373.4

D

APPENDIX D

AT&T CORP.
ANNUAL REPORTS AND SEC FILINGS

AT&T 1994 Annual Report

With 5% of the $1.5 trillion global information industry, AT&T is a small fish with lots of room  to grow.

The merger of AT&T and McCaw is the best and quickest way for the two companies to take advantage of developing opportunities in a dynamic industry.

Financial Section

A Discussion and Analysis of Our Results and Operations

The merger was one of the most important events of 1994 for us. Shareowners now own a stronger AT&T with even better prospects for growth in revenues and earnings. Our customers will choose from a wider array of services.

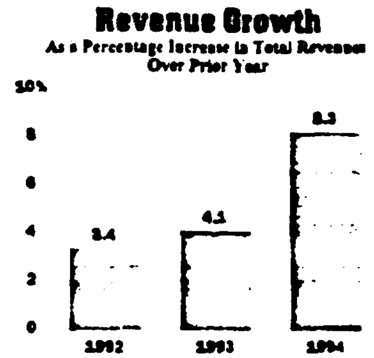
Though completed, the merger remains subject to legal reviews. In addition, under the terms of a proposed antitrust consent decree between AT&T and McCaw and the United States, the operations of AT&T and McCaw are subject to several conditions, including keeping McCaw as a separate business with its own officers and employees. After McCaw provides equal access connections to other long distance carriers, McCaw may use the AT&T brand on McCaw's cellular services, and AT&T may jointly market AT&T's long distance and McCaw's cellular services, and provide customers with a single bill for both. For the most part, these restrictions merely confirm commitments we made when we announced our merger plans and they do nothing to alter the fundamental logic or economics of the merger.

Operating now as the wireless unit of AT&T, McCaw is the leading U.S. provider of wireless communications services, which include cellular, messaging, data transmission and air-to-ground services. McCaw has cellular operations in more than 100 cities. In most markets McCaw offers its services under the brand name Cellular One®. McCaw also operates the sixth largest U.S. messaging service, serving more than 700,000 customers, and a digital air-to-ground telephone service for commercial airlines and corporate aircraft.

AT&T's Strong Financial Performance

Accelerating revenue growth in products and services, aided by effective cost and expense controls, boosted earnings to another record in 1994. The climate for growth improved this past year because of better economic conditions, and changes in technology and world trade that spurred demand for network services as well as new networks. We look forward to continued growth in revenues and earnings in 1995.

Our financial performance was also strong in 1992 and 1993. Our performance met growth targets despite the less favorable business and economic environment. In 1993 we also had to adopt new accounting methods. Because new



In 1994 we achieved revenue growth that matches the 8–10% annual growth of the global information industry as a whole.

rules apply to all U.S. companies, we changed our accounting for retiree benefits, postemployment benefits and income taxes. The net $9.6 billion after-tax charge to bring our financial statements in line with the new accounting methods caused us to report a net loss for that year. But those accounting changes do not affect cash flows; they only change the expenses we report.

In our accounting for *retiree benefits*, we estimate and book expenses during the years employees are working and accumulating future benefits. When we used the former "pay-as-you-go" accounting, we simply booked our contributions to trust funds for life insurance benefits and the actual claims for benefits such as health care and telephone concessions as they occurred.

Our accounting for *postemployment benefits*, including payments for separations and disabilities, is very similar to the accounting for retiree benefits. We book expenses for future separations during the years employees are working and accumulating service with the company and for disability benefits when the disabilities occur. In the former accounting method, we booked expenses for separations when we approved them and for disabilities when we made payments. Compared with 1992, this change increased our costs and expenses by $301 million in 1993, which reduced earnings $171 million, or $0.11 per share.

Our accounting for *income taxes* uses the enacted tax rates to compute both deferred and current income taxes. Using our former method, we held deferred tax assets and liabilities at their original values even when Congress changed the tax rates.

Consolidated Statements of Income

AT&T Corp. and Subsidiaries, Years Ended December 31

Dollars in millions (except per share amounts)	1994	1993	1992
Sales and Revenues			
Telecommunications services	$43,425	$41,623	$40,968
Products and systems	21,161	17,925	16,579
Rentals and other services	7,391	7,299	7,206
Financial services and leasing	3,117	2,504	1,894
Total revenues	75,094	69,351	66,647
Costs			
Telecommunications services			
Access and other interconnection costs	17,797	17,772	18,186
Other costs	7,466	7,623	7,553
Total telecommunications services	25,263	25,395	25,739
Products and systems	13,273	10,966	9,976
Rentals and other services	3,629	3,563	3,366
Financial services and leasing	2,152	1,711	1,310
Total costs	44,317	41,635	40,391
Gross margin	30,777	27,716	26,256
Operating Expenses			
Selling, general and administrative expenses	19,637	18,037	16,704
Research and development expenses	3,110	3,111	2,924
Total operating expenses	22,747	21,148	19,628
Operating income	8,030	6,568	6,628
Other income – net	236	476	163
Loss on sale of stock by subsidiary	—	9	—
Interest expense	748	1,032	1,153
Income before income taxes and cumulative effects of accounting changes	7,518	6,003	5,638
Provision for income taxes	2,808	2,301	2,196
Income before cumulative effects of accounting changes	4,710	3,702	3,442
Cumulative effects on prior years of changes in accounting for:			
Postretirement benefits (net of income tax benefit of $4,294)	—	(7,023)	—
Postemployment benefits (net of income tax benefit of $681)	—	(1,128)	—
Income taxes	—	(1,457)	—
Cumulative effects of accounting changes	—	(9,608)	—
Net Income (Loss)	$ 4,710	$ (5,906)	$ 3,442
Weighted average common shares outstanding (millions)	1,564	1,547	1,519
Per Common Share:			
Income before cumulative effects of accounting changes	$ 3.01	$ 2.39	$ 2.27
Cumulative effects of accounting changes	—	(6.21)	—
Net Income (Loss)	$ 3.01	$ (3.82)	$ 2.27

The notes on pages 33 through 4[illegible] are an integral part of the consolidated financial statements

Consolidated Balance Sheets

AT&T Corp. and Subsidiaries at December 31

Dollars in millions (except per share amount)	1994	1993
Assets		
Cash and temporary cash investments	$ 1,208	$ 671
Receivables, less allowances of $1,251 and $1,040		
Accounts receivable	13,671	12,294
Finance receivables	14,952	11,370
Inventories	3,633	3,222
Deferred income taxes	3,030	2,079
Other current assets	1,117	732
Total current assets	37,611	30,368
Property, plant and equipment – net	22,035	21,015
Licensing costs – net	4,251	3,995
Investments	2,708	3,060
Finance receivables	4,513	3,815
Prepaid pension costs	4,151	3,575
Other assets	3,993	3,565
Total assets	$79,262	$69,393
Liabilities and Deferred Credits		
Accounts payable	$ 6,011	$ 4,853
Payroll and benefit-related liabilities	4,105	3,802
Postretirement and postemployment benefit liabilities	1,029	1,301
Debt maturing within one year	13,666	11,063
Dividends payable	518	448
Other current liabilities	5,601	4,587
Total current liabilities	30,930	26,054
Long-term debt including capital leases	11,358	11,802
Postretirement and postemployment benefit liabilities	8,754	9,083
Other liabilities	4,285	4,363
Deferred income taxes	3,913	2,231
Unamortized investment tax credits	232	270
Other deferred credits	776	263
Total liabilities and deferred credits	60,248	54,066
Minority interests	1,093	648
Redeemable preferred stock	—	1,305
Common Shareowners' Equity		
Common shares par value $1 per share	1,569	1,547
Authorized shares: 2,000,000,000		
Outstanding shares: 1,569,006,000 at December 31, 1994; 1,546,518,000 at December 31, 1993		
Additional paid-in capital	15,825	14,324
Guaranteed ESOP obligation	(305)	(355)
Foreign currency translation adjustments	145	(32)
Retained earnings (deficit)	687	(2,110)
Total common shareowners' equity	17,921	13,374
Total liabilities and shareowners' equity	$79,262	$69,393

The notes on pages 35 through 45 are an integral part of the consolidated financial statements

Reclassifications

We reclassified certain amounts for previous years to conform with the 1994 presentation.

2. Changes in Accounting Principles

Postretirement Benefits

We adopted Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective January 1, 1993. This standard requires us to accrue estimated future retiree benefits during the years employees are working and accumulating these benefits. Previously, we expensed health care benefits as claims were incurred and life insurance benefits as plans were funded.

We also reimburse the divested regional Bell companies for a portion of their costs to provide health care benefits, increases in pensions and other benefits to predivestiture retirees under the terms of the Divestiture Plan of Reorganization. Through 1992 we expensed these reimbursements as incurred.

We recorded a one-time pretax charge for the unfunded portions of these liabilities of $11.317 million ($7,023 million or $4.54 per share after taxes). Apart from these cumulative effects on prior years of the accounting change, our change in accounting had no material effect on net income and it does not affect cash flows.

Postemployment Benefits

We also adopted SFAS No. 112, "Employers' Accounting for Postemployment Benefits," effective January 1, 1993. Analogous to SFAS No. 106, this standard requires us to accrue for estimated future postemployment benefits, including separation payments, during the years employees are working and accumulating these benefits, and for disability payments when the disabilities occur. Before this change in accounting, we recognized costs for separations when they were approved and disability benefits when they were paid.

We recorded a one-time pretax charge for the unprovided portion of these liabilities of $1,809 million ($1,128 million or $0.73 per share after taxes). The change in accounting reduced operating income by $301 million and net income by $171 million ($0.11 per share) in 1993. This change does not affect cash flows.

Income Taxes

We also adopted SFAS No. 109, "Accounting for Income Taxes," effective January 1, 1993. Among other provisions, this standard requires us to compute deferred tax amounts using the enacted corporate income tax rates for the years in which the taxes will be paid or refunds received. Before 1993 our deferred tax accounts reflected the rates in effect when we made the deferrals.

The adoption of this standard reduced net income by $1,457 million ($0.94 per share) as a result of deferred liabilities that were created by McCaw Cellular Communications, Inc. acquisitions prior to the merger. Apart from these cumulative effects on prior years of the accounting change, the new accounting method had no material effect on net income in 1993. Unless Congress changes tax rates, we do not expect this change to affect net income materially in future periods. This change does not affect cash flows.

3. Prospective Accounting Changes

Impaired Loans

In 1995 we must adopt SFAS No. 114, "Accounting by Creditors for Impairment of a Loan." This standard requires us to compute present values for impaired loans when determining our allowances for credit losses. We do not expect this new standard to affect net income materially at or after adoption, and it will not affect cash flows.

4. Merger with McCaw Cellular Communications, Inc. (McCaw)

On September 19, 1994, AT&T merged with McCaw. As a result, 197.5 million shares of McCaw common stock were converted into shares of AT&T common stock at an exchange ratio of one share of AT&T common stock for each McCaw share. In addition, AT&T assumed 11.3 million McCaw stock options which were converted into AT&T stock options at the same exchange ratio, resulting in 11.3 million additional AT&T stock options at an average exercise price of $27.43. The merger was accounted for as a pooling of interests, and the consolidated financial statements were restated for all periods prior to the merger to include the accounts and operations of McCaw. Intercompany transactions prior to 1994 were not eliminated due to immateriality. Merger-related expenses of $246 million incurred in 1994 ($187 million net of taxes) were reported as selling, general and administrative expenses. Certain reclassifications were made to McCaw's accounts to conform to AT&T's presentation. Premerger operating results of the companies in the current presentation were:

Dollars in millions	Nine Months Ended September 30, 1994	Year Ended December 31, 1993	1992
Sales and Revenues			
AT&T	$52,178	$67,156	$64,904
McCaw	2,062	2,195	1,743
Eliminations	(256)	—	—
Total	$53,984	$69,351	$66,647
Net Income (Loss)			
AT&T	$ 3,431	$ (3,794)	$ 3,807
McCaw	34	(2,112)*	(365)
Eliminations	(93)	—	—
Total	$ 3,372	$ (5,906)	$ 3,442

*Includes a charge of $45 million previously reported as an extraordinary item for the early redemption of debt

AT&T

Bringing People Together

1993 Annual Report

Anytime

Anywhere

Our growth comes from competing successfully worldwide in both old and new markets, offering new technology and high-quality products and services.

Consolidated Income Statement Information

Dollars in millions	1993	1992	1991
Total revenues	$67,156	$64,904	$63,089
Total costs	40,569	39,710	38,825
Gross margin	26,587	25,194	24,264
Provisions for business restructuring	498	64	3,572
Other operating expenses	19,851	18,861	19,334
Operating income	$ 6,238	$ 6,269	$ 1,358
Income before cumulative effects of accounting changes	$ 3,974	$ 3,807	$ 522
Cumulative effects of accounting changes	(7,768)	—	—
Net Income (Loss)	$ (3,794)	$ 3,807	$ 522
Gross margin percentage	39.6%	38.8%	38.5%
Operating margin percentage	9.3%	9.7%	2.2%

A discussion and analysis of our results and operations

Global economic conditions improved in 1993, but growth was still sluggish. In Europe and Japan the weak conditions of 1991 and 1992 continued this past year. Against this backdrop, we reported a 3.5% increase in total revenues in 1993, a pickup from the 2.9% increase in 1992.

We made three accounting changes this past year. Because new rules apply to all U.S. companies, we changed our accounting for retiree benefits, postemployment benefits and income taxes. The net after-tax charge to bring our financial statements in line with the new accounting methods caused us to report a net loss for the year. Excluding that net charge and the increase in 1993 expenses caused by the change in accounting for postemployment benefits and a fourth-quarter restructuring charge, our per share earnings were $3.15 in 1993. These accounting changes do not affect cash flows; they only change the expenses we report.

In our new accounting for *retiree benefits*, we estimate and book expenses for retiree benefits during the years employees are working and accumulating these future benefits. When we used the former "pay-as-you-go" accounting, we simply booked our contributions to trust funds for life insurance benefits and the actual claims for benefits such as health care and telephone concessions as they occurred. To use the new method, we made assumptions about trends in health care costs, interest rates and average life expectancy. Then we estimated the future payments for benefits to all present retirees and for accumulated benefits of active em-

Why do we make accounting changes?

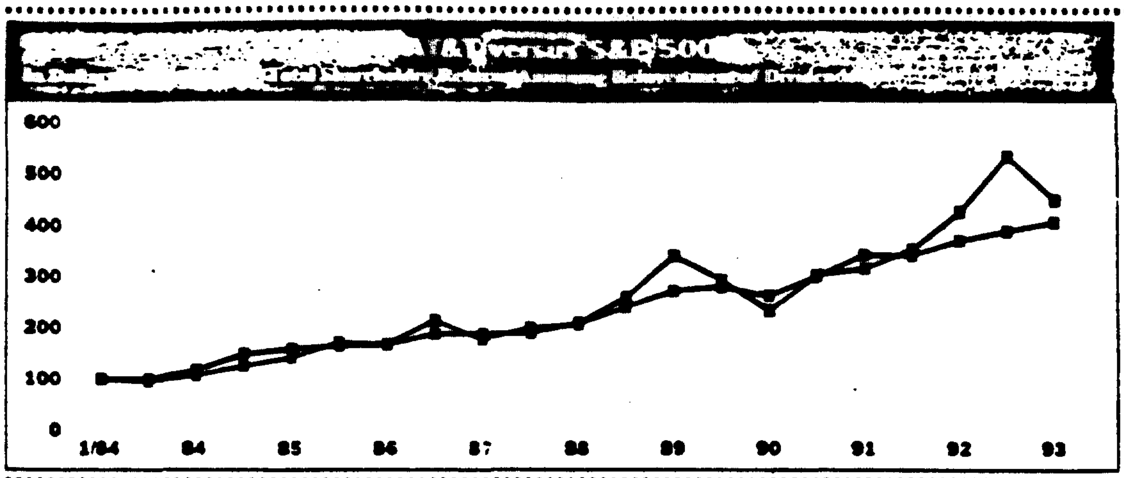
The goal of financial reporting and our objective at AT&T is to give investors the information they need to understand how we're doing over time and in comparison with other companies. Sometimes accounting rule-makers issue new rules for all companies. At other times, we decide to change our methods because of trends in our business or industry.

How do we make the changes?

We first figure out what our balance sheet would look like if we had always used the new accounting methods. Then we make all the adjustments needed to catch up with those new methods. Our income statement shows the net impact of all those adjustments as "cumulative effects on prior years of changes in accounting."

What do the changes mean to results?

Accounting changes sometimes have a large effect on reported earnings in the year of a change, but the effects on future earnings may be quite small once we bring the balance sheet up to date. Because the cumulative effects come from earlier years, many investors set them aside when looking at current results. The income statement format allows investors to see our results easily with or without these cumulative effects of accounting changes.



Your investment has outperformed the S&P 500 for the past decade.

■ AT&T
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Assumes $100 invested in the new AT&T Common Stock and in the S&P 500 Index on January 1, 1984 and all dividends reinvested.

ployees. We then placed this $11.3 billion liability on the books to reflect those estimated future obligations at January 1, 1993, expressed in today's dollars. From now on, we will continue to record the expenses as employees accumulate future benefits so that our liability for retiree benefits is always up to date. We expect our annual expenses to be at about the same level we recorded before this accounting change.

Our new accounting for *postemployment benefits*, including payments for separations and disabilities, is very similar to our new accounting for retiree benefits. We must book expenses for future separations during the years employees are working and accumulating service with the company, and for disability benefits when the disabilities occur. Using the former method, we booked expenses for separations when we identified them and expenses for disabilities when we made payments. We used our experience over the past five years to estimate future separations. In the future, we will adjust our estimates based on the number of employees who actually leave our payroll with these payments. Because we book expenses every quarter using this accounting method instead of booking expenses when we make plans to restructure our business, this change increased our costs and expenses by $301 million in 1993, and reduced our earnings by $171 million, or $0.13 per share. We expect our earnings in 1994 to be similarly reduced.

Our new accounting for *income taxes* uses the enacted tax rates to compute both deferred and current taxes. That means we must refigure our deferred tax assets and liabilities whenever Congress changes tax rates. Using our former method, we held deferred tax assets and liabilities at their original values even when tax rates changed. Because federal corporate tax rates are lower now than they were before the 1986 Tax Act, we had a gain when we changed to the new accounting method. Apart from the effects of changes in statutory tax rates, we do not expect the new accounting to affect future earnings materially.

An overview of our business operations ....

Our core business is to meet the communications and computing needs of our customers by using networks to move and manage information. We divide the revenues and costs of this core business into three categories on our income statement: *telecommunications services*, *products and systems*, and *rentals and other services*. AT&T Capital Corporation (AT&T Capital) and AT&T Universal Card Services Corp. (Universal Card) are partners with our core business units as well as innovators in the financial services industry. We include their revenues and costs in a separate category on our income statement: *financial services and leasing*.

Customer demand for the products and services of our core business continues to grow despite weak economic conditions worldwide. Technological advances and brisk competition are making electronic communications and computing ever more useful and economical. Our financial services businesses are also growing because we are investing in new assets.

We look forward to greater revenue growth in 1994 than in 1993 because of a strengthening economy and the expected completion of our merger with the fast-growing McCaw Cellular Communications, Inc. (McCaw).

Our merger with McCaw aims to give our customers a more comprehensive service offering and our investors faster growth and higher long-term returns on their investment.

Our plan is for McCaw's owners to exchange their McCaw stock for new AT&T stock. Then all owners of the post-merger AT&T will share in the benefits and risks of the combined operations. The people, assets and capital of the two firms won't change just because of this merger.

In mergers like this, we simply add up the earnings, assets, liabilities and equity of the two companies and become one company. We used this same method, called a "pooling of interests," for the merger of AT&T and NCR in 1991.

After a merger, financial statements and all other financial information show the combined amounts as if there had always been only one company. To help you picture this, we included some of these combined amounts at the bottom of the ten-year summary of selected financial data. We computed these amounts assuming the merger was already completed using a one-for-one exchange of shares as AT&T and McCaw proposed in the merger agreement.